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C O N F I D E N T I A L SECTION 01 OF 03 HONG KONG 002981

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SUBJECT: MACAU ECONOMIC GROWTH ACCELERATING

REF: 05 HONG KONG 4376

Classified By: E/P Acting Chief Jeff Zaiser. REASONS: 1.4(b,d).

¶1. (C) Summary: Macau's economy is again picking up steam as GDP growth surged 18.8 percent in the first quarter of 2006. Growth is being driven largely by the booming tourism and gaming sectors, and by massive investment in a number of large-scale casino and infrastructure projects. Tax receipts from the casino industry, which generates 75 percent of Government revenue, pushed the Government's budget surplus to \$870 million (6.7 billion patacas) in the first half of 2006, prompting Moody's Investors Services on July 7 to upgrade their outlook for Macau's Government bond rating from neutral to positive. Each of our contacts emphasized that the biggest problem facing Macau is a shortage of skilled labor. Macau Monetary Authority Chairman (MMA) Anselmo Teng also fears that the booming economy will push inflation above 6.0 percent by the end of 2006, though he said the MMA "could live with" inflation of up to 9 percent. Teng told us that the banking sector is "doing quite remarkable," and that the U.S. Treasury Department's designation of Banco Delta Asia (BDA) as a primary money launderer in September 2005 (see reftel) has had little lasting impact on Macau's banking sector as a whole. End Summary.

¶2. (C) On July 19, we discussed Macau's economic developments with MMA Chairman Anselmo Teng, Wynn Resorts Macau President Grant Bowie, and English-language daily "Macau Post" Director Harald Bruning.

Let the Good Times Roll  
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¶3. (C) After turning in lackluster growth (for Macau) of only 6.7 percent in 2005, Macau's economy is again picking up steam. The economy expanded 8.9 percent (in real terms) in the fourth quarter of 2005 compared with the same period in 2004, then grew 18.8 percent in the first quarter of 2006, year-on-year, according to the Macau Economic Bulletin. Growth is being driven largely by the booming tourism and gaming sectors, and by massive investment in a number of large-scale casino and infrastructure projects. Total investment was up 56.9 percent in 2005 in real terms, and accelerated further in the first quarter of 2006, rising 68.1 percent, year-on-year. Private and public investment climbed 67.9 percent and 79.8 percent, respectively, in Q1 2006. This investment is plainly evident upon arriving in Macau, as the entire city seems to be under construction. The pace of road construction in particular seems to have accelerated just within the past few months. Bruning told poloff that in addition to the numerous road and bridge projects now

underway, several tunnels are being planned, including one that would link the Macau peninsula with Taipa and Coloane islands, where Macau's version of the "Las Vegas strip" is currently being built.

14. (C) Despite the many inconveniences associated with all this construction, the number of visitors to Macau continues to climb, rising 12.2 percent to 18.7 million in 2005, and up another 17.7 percent, year-on-year, in Q1 2006. Most importantly, the number of overnight visitors (versus daytrippers from Hong Kong and Zhuhai) climbed 17.3 percent in Q1, while per capita visitor spending rose 4.8 percent. The number of mainland tourists increased 19.8 percent in Q1 2006 to 2.9 million -- 53.5 percent of the total.

15. (C) According to figures released on July 18, the Government's budget surplus surged to \$870 million (6.7 billion patacas) in the first half of 2006 on the back of strong casino tax receipts. Government revenue was \$1.6 billion (12.5 billion patacas), up 18.2 percent from a year earlier, and expenditures were \$753 million (5.8 billion patacas), up 6.4 percent. Casino tax receipts rose 14.7 percent to \$1.2 billion (9.3 billion patacas), accounting for nearly 75 percent of total Government revenue. Anselmo Teng said that the MMA invested the surplus funds primarily in foreign debt instruments, including US Dollar, Euro, and Japanese Yen-denominated Government bonds, though he declined to give a precise break-down. On the other hand, Grant Bowie told us that he believed much of these surpluses were being wasted through corruption. He worried that the Macau Government was not taking full advantage of an historic opportunity to make long-term investments in Macau's social and physical infrastructure, particularly in education. He said that Macau's antiquated bureaucracy was simply not up to

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the task.

16. (C) The strong budget figures prompted Moody's Investors Services on July 7 (they apparently had prior access to the figures) to upgrade their outlook for Macau's Government bond rating from neutral to positive -- though Macau has no public debt. Moody's said in a press release that the Macau Government "has recently recorded strong surpluses on the back of tax revenues from the gambling industry." Moody's also raised Macau's local currency rating from Aa1 to Aaa, the highest possible for debt denominated in local currency. The statement said there was "minimal risk" of a currency revaluation.

Too Much of a Good Thing

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16. (C) Each of our contacts emphasized that the biggest problem facing Macau is a shortage of labor, particularly of skilled labor in the fields of information technology, accounting, and finance. Anselmo Teng told us that Macau's universities simply can't provide enough graduates in these fields. The unemployment rate now stands at 3.9 percent, though Bruning told us that even this relatively low figure is probably biased upward. Bruning said that many workers who were nominally unemployed were actually working in the informal economy, which includes various illicit businesses and a vibrant underground cross-border trade between Macau and Zhuhai. According to Bruning, "anyone who wants a job in Macau can easily get one." Teng told us that the Government is trying to attract professionals, particularly accountants, from throughout South East Asia. Macau's various labor organizations, particularly blue-collar workers in the construction industry, have a history of vigorously opposing the importation of labor. However, Teng told us that such opposition is softening as the labor shortage becomes more acute. Teng said that the Government and labor organizations have essentially reached a consensus that Macau needs to import more "human resources," and the Government has given assurances that it will "exercise very good control" over the

process.

17. (C) Teng also fears a pickup in inflation, which he predicted could rise from the current 5.5 percent to more than 6.0 percent by the end of 2006. Rising prices are being fueled not only by the massive inflow of investment, but also by the increasing price of imports, specifically oil. With the Macau Pataca linked to the Hong Kong Dollar, which, in turn, is linked to the U.S. Dollar, the MMA lacks the ability to conduct an independent monetary policy. However, Teng was thankful that the U.S. and Macau economies seemed to be in relative macroeconomic sync at this point, so that rising U.S. interest rates came at the right time to help cool Macau's overheating economy. Teng said that some local economists were arguing for a delay in Government infrastructure projects to help cool the economy. However, Teng said that the Government would not agree to such delays because of the need to provide critical infrastructure for the many casino projects. Teng said the MMA "can live with" an inflation rate of up to 9 percent, but that double-digit inflation would be a cause for concern.

18. (C) Teng lamented that as the economy becomes increasingly dependent on the gaming sector, Macau was now "quite vulnerable" to a downturn in the mainland economy, and to threats such as Avian Flu. Mainland visitors now account for more than 53 percent of all tourists coming to Macau, and Teng predicted that that percentage would continue to rise as other mainland cities are brought into the Individual Visit Scheme (IVS) over the next year. (Note: the IVS allows mainland residents in certain cities and provinces to travel to Macau on an individual tourist basis for a maximum of 7 days. Previously, mainland residents could only come to Macau as part of a group tour or on a business visa. Currently, all of Guangdong province, and 11 other cities, including Beijing and Shanghai, are included in the IVS. End Note.) To counter this threat, the Government is trying to diversify the economy through the promotion of the Macau-Zhuhai cross-border industrial zone. While Teng also stressed that the Closer Economic Partnership Agreement (CEPA) with China would provide a boost to non-gaming industries, he admitted that Macau's economy would become increasingly one-dimensional in the coming years. When we asked about the possibility of an eventual link between the Pataca and the Renminbi given the increasingly close relationship between the mainland Chinese and Macau

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economies, Teng said there was no consideration of such a move. Teng said that Macau "had 20 years of stability with its link to the Hong Kong Dollar," and he saw "no reason to change."

No BDA Hangover for the Banking Sector

19. (C) Teng told us that the U.S. Treasury Department's designation of Macau's Banco Delta Asia (BDA) as a primary money launderer in September 2005 has had little lasting impact on Macau's banking sector as a whole. He said the sector was "doing quite remarkable." He said the aggregate non-performing loan ratio for Macau banks was currently 1.7 percent, and the capital adequacy ratio was more than 15 percent -- much higher than the 8 percent required by international banking standards. He said that in supervising banks, the MMA was moving from an approach based on asset quality to a risk-based approach. Teng was not overly concerned about the risk to the banks of a downturn in the gaming and tourism industries. Macau banks have remarkably little direct exposure to the gaming industry, and the branches of mainland banks operating in Macau have no exposure, Teng said. The casino projects were funded primarily by Hong Kong banks through syndicated loans. Sakaue